Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1075

THE NEW YORK TRUST COMPANY, as surviving Trustee of Seaboard Air Line Railway Refunding Mortgage,
Petitioner,

against

MARYLAND TRUST COMPANY, as Successor Trustee under Seaboard Air Line Railway First Mortgage.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

ALBRIDGE C. SMITH,
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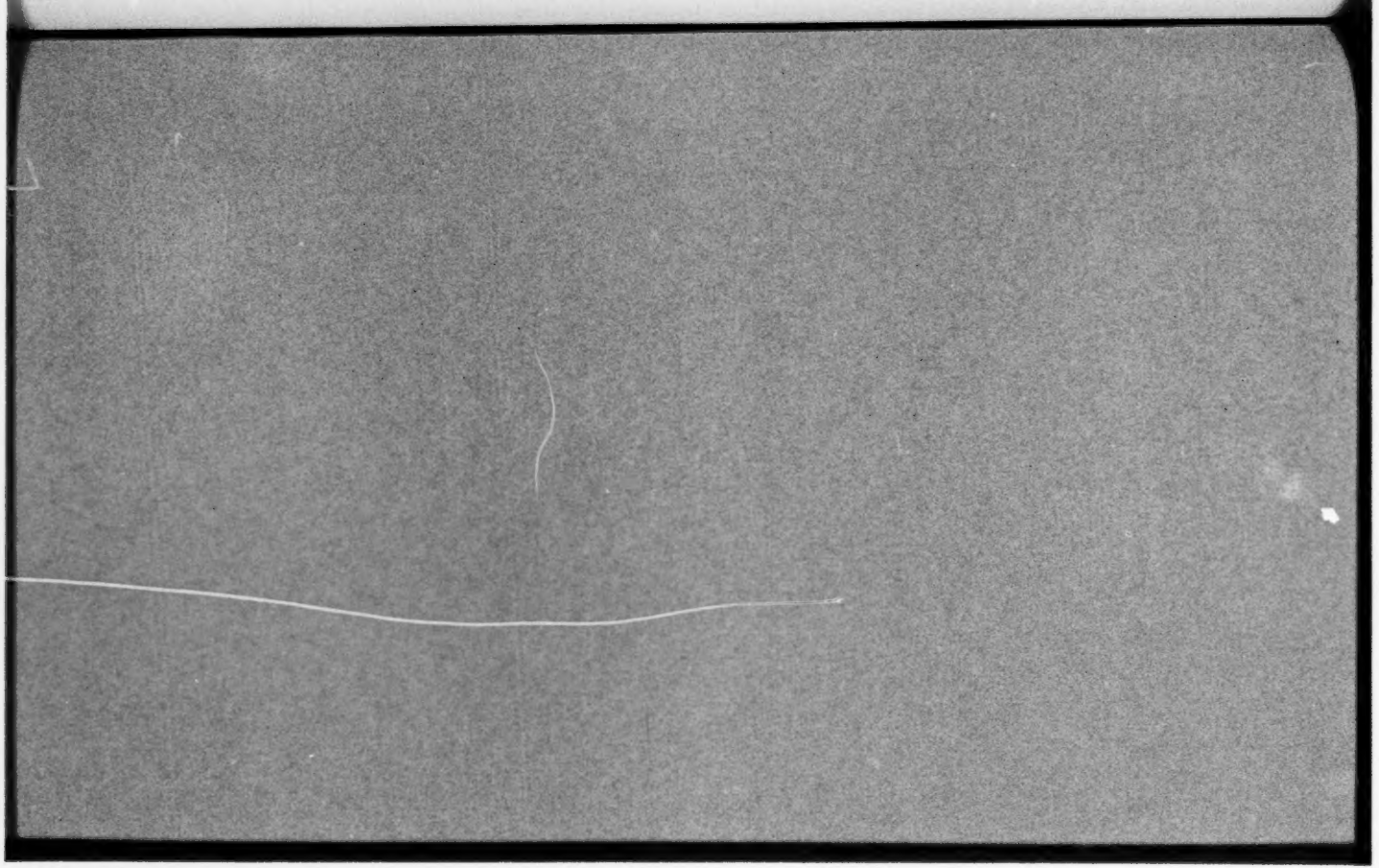

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner above named submits its petition for a writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above case on January 6, 1942 (R. 228)*

* The record referred to is the printed portion thereof as stipulated by the parties for the purposes of this petition, and such record is the same as that on file in connection with the petition for a writ of certiorari filed herein March 6, 1942, by Legh R. Powell, Jr., and Henry W. Anderson, as Receivers of the property of Seaboard Air Line Railway Company (Docket No. 1021) relating to the same decree below.

modifying and affirming the decree of the District Court of the United States for the Eastern District of Virginia (R. 192).

Subsequent to the decree of the Circuit Court and on February 25, 1942, Mr. Mortimer N. Buckner, the individual co-Trustee with your petitioner under said Refunding Mortgage, died. Therefore, this action on behalf of the Refunding Mortgage continues in the name of The New York Trust Company, the sole surviving Trustee, since the rights sought to be enforced on behalf of the Refunding Mortgage survived to your petitioner, The New York Trust Company.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (Chapter 229, 43 Stat. 936). The decree of the Circuit Court of Appeals sought to be reviewed was entered on January 6, 1942.

Summary Statement of Matter Involved.

The question raised by this petiton hinges on the rule of *Erie R. Co. v. Tompkins,* 304 U. S. 64, as applied to Maryland common law regarding the apportionment of stock dividends between principal and income, which question was the subject of the dissenting opinion of Soper, J., below (R. 220). Hence the facts set forth in this petition are restricted to those germane to this question.

On December 23, 1930, Receivers were appointed for Seaboard Air Line Railway Company by the United States

District Court, Eastern District of Virginia, on a general creditor's bill in equity (R. 1). Jurisdiction of the receivership cause depended on diversity of citizenship.

Among securities owned by Seaboard when its Receivers were appointed were 6,675 shares of capital stock of Richmond-Washington Company, a New Jersey corporation, of which 2,225 shares were the result of a 50% stock dividend issued prior to Seaboard's receivership.

Each of the parties to this three-cornered controversy, to wit:

> (1) Maryland Trust Company, Successor Trustee of Seaboard Air Line Railway First Mortgage dated April 14, 1900;
>
> (2) Your petitioner, The New York Trust Company, surviving Trustee of Seaboard Air Line Railway Refunding Mortgage dated October 1, 1909; and
>
> (3) Legh R. Powell, Jr., and Henry W. Anderson, as Receivers of Seaboard Air Line Railway Company;

claimed a first lien upon, and the right to possession of, the 2,225 stock dividend shares of Richmond-Washington Company, together with cash dividends pertaining thereto, all of which were held by the Seaboard Receivers; the Receivers' claim, being on behalf of Receivers' certificates and general creditors of Seaboard. Mention of "Seaboard" includes the various predecessor railway corporations of the same name since the corporate succession of Seaboard through various mergers and consolidations is immaterial to the question raised by this petition.

Richmond-Washington Company, through stock ownership, controls Richmond, Fredericksburg & Potomac Railroad Company operating a line of railway between Washington, D. C., and Richmond, Virginia. Richmond-Wash-

ington Company's charter was filed September 5, 1901, and in the same month Seaboard acquired 4,450 shares of its capital stock (par value $100 per share) at a cash price of $445,000. At the date of such acquisition by Seaboard each share of outstanding Richmond-Washington Company stock had a book value of $100. Upon such acquisition and on September 28, 1901, Seaboard conveyed its 4,450 shares of Richmond-Washington Company to The Continental Trust Company of Baltimore, Maryland, predecessor Trustee of the First Mortgage, to which Maryland Trust Company, respondent hereto, succeeded as Trustee in 1930. Such conveyance was an addition to the corpus of the trust estate then held by the First Mortgage Trustee by way of mortgage and pledge, as security for bonds issued under the First Mortgage which was a general railway system lien.

While the validity of the pledge of these 4,450 shares is not questioned, there is no provision in the First Mortgage which required the pledge of Richmond-Washington Company stock nor does the First Mortgage contain any after-acquired property provision pertaining to such stock.

The First Mortgage was executed April 14, 1900, in Virginia by Seaboard (as then constituted a corporation of the States of Virginia and North Carolina), and thereafter was delivered to The Continental Trust Company in Baltimore, Maryland, where it was executed by said trust company two days later on April 16, 1900. The Continental Trust Company was a Maryland corporation having its sole place of business in Baltimore. Likewise, on September 28, 1900, when the original 4,450 shares of Richmond-Washington Company were delivered by Seaboard to The Continental Trust Company, as Trustee, such delivery was made in Baltimore.

On October 1, 1909, Seaboard executed and delivered to your petitioner and Mortimer N. Buckner, as Trustees, its Refunding Mortgage of that date. Under the granting clauses of the Refunding Mortgage, Seaboard conveyed stock of Richmond-Washington Company in the following descriptive manner:

> "(b) The following bonds and shares of stock subject to the lien of the Seaboard First Mortgage, and to the lien of the Three-Year Mortgage, and now in possession of The Continental Trust Company, Baltimore, Maryland, Trustee of the Seaboard First Mortgage:
>
> "1. 4,450 shares of the capital stock of Richmond-Washington Company;
>
> • • • • • •
>
> "(g) All shares of stock of any of the companies shares of stock whereof are pledged or agreed to be pledged hereunder in the foregoing sub-clauses (a), (b), (d) and (e), which the Railway Company now owns or shall hereafter acquire;" (R. 66).

On October 31, 1930, Richmond-Washington Company, as above indicated, issued a 50% stock dividend which previously had been authorized by appropriate charter amendment and directors' action, as a result of which Seaboard received on said date 2,225 shares of Richmond-Washington Company stock as a dividend in respect of its original 4,450 shares held in pledge by the First Mortgage Trustee. The stock dividend was paid out of surplus derived wholly from profits of Richmond-Washington Company which had accumulated after September 28, 1901, the date of the conveyance in trust to the First Mortgage Trustee of the original 4,450 shares. Seaboard retained the 2,225 stock divi-

dend shares, as did the Seaboard Receivers upon their appointment December 23, 1930, and the Seaboard Receivers have continued to collect and hold cash dividends on the stock dividend shares aggregating, through 1937, $89,556.25.

Immediately prior to the stock dividend each share of Richmond-Washington Company had a book value of $263.75, and immediately after such dividend each share had a book value of $175.83; all as compared to the book value of $100 per share when the original 4,450 shares were acquired by Seaboard and conveyed in pledge to the First Mortgage Trustee. The capital stock of Richmond-Washington Company was owned in equal portions by six separate railroads, including Seaboard.

Section 1 of Article Nine of the First Mortgage provides:

> "SECTION 1. Until some default shall have been made * * * the 'Railroad Company' * * * shall be suffered and permitted to retain actual possession of all the premises hereby mortgaged, and to manage, operate and use the same and every part thereof with the rights and franchises appertaining thereto, and *to collect, receive, take, use and enjoy the tolls, earnings, income, rents, issues and profits thereof.*" (R. 64). (Emphasis ours.)

In respect of pledged securities, Section 1 of Article Three of the First Mortgage provides:

> "SECTION 1. Unless (a) the 'Railroad Company' shall be in default * * * the 'Railroad Company' shall be entitled to receive *all interest paid or dividends declared in respect of any bonds or stocks transferred to or pledged with the 'Trustee'* pursuant to any of the provisions of this indenture * * *" (R. 46). (Emphasis ours.)

When the stock dividend was issued there was no default under the First Mortgage.

The Special Master, the District Court and a majority of the Circuit Court of Appeals have sustained the claim of the First Mortgage Trustee to a first lien upon, and right to possession of, the 2,225 stock dividend shares and the accumulated cash dividends thereto pertaining. Such decision contravenes your petitioner's claim that Seaboard, having acquired the 2,225 shares subsequent to the date of the Refunding Mortgage, free of any lien of the First Mortgage, such shares come within the operation of the specific after-acquired property provision of the granting clauses of the Refunding Mortgage pertaining to any shares of Richmond-Washington Company which Seaboard should acquire after the date of the Mortgage; and that hence your petitioner, as Trustee of the Refunding Mortgage, has a first lien upon, and the right to possession of, said shares together with the accumulated cash dividends pertaining thereto.

The Special Master, the District Court and the majority of the Circuit Court arrived at their conclusion upon the authority of *Gibbons* v. *Mahon*, 136 U. S. 549 and other federal and state decisions* (other than Maryland decisions) which stem from *Gibbons* v. *Mahon*, following the so-called *Massachusetts* rule (*Minot* v. *Paine*, 99 Mass. 101) relating to the disposition of stock dividends as between principal and income; despite the fact that Maryland common law rejected the theory of *Gibbons* v. *Mahon* and adopted the so-called *Pennsylvania* rule of apportionment governing dividends, both cash and stock, a rule distinctly different from the *Massachusetts* rule.

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* *Hayes* v. *St. Louis Union Trust Co.*, 317 Mo. 1028, 298 S. W., 91; *Kaufman* v. *Charlottesville Woolen Mills Co.*, 93 Va. 673, 25 S. E. 1003; and *Lancaster Trust Co.* v. *Mason*, 152 N. C. 660, 68 S. E. 235.

In the absence of provision to the contrary, the federal or *Massachusetts* rule considers a cash dividend always income and a stock dividend always principal; whereas the *Pennsylvania* rule considers that an extraordinary dividend, whether in cash or stock may be capital or income, depending on the period during which the corporate surplus out of which the dividend is declared accumulated.

The dissenting opinion of Soper, J., disagrees with the holding of the majority opinion below that it is permissible to disregard Maryland dividend cases in favor of "the contrary decisions of the courts of Missouri or Virginia or North Carolina or the United States" (R. 227), thus violating the rule of *Erie R. Co.* v. *Tompkins, supra.* The Circuit Court majority concede that the law of Maryland governs.

Opinions of the Courts Below.

The report of the Special Master to whom this case was referred by the District Court appears at page 132 of the Record. The opinion of the District Court (R. 185) has not yet been reported. The majority opinion of Parker, J., of the Circuit Court (R. 199), and the dissenting opinion of Soper, J., of said Court (R. 220) are reported in 125 F. (2nd) p. 260.

Question Presented.

The sole question raised by this petition is:

> Under a proper interpretation of the contractual terms of the First Mortgage under Maryland law, did Seaboard acquire the 2,225 stock dividend shares of Richmond-Washington Company free of any lien thereon of the First Mortgage?

The interest which your petitioner has in this question is that if it should be answered affirmatively upon a review by this Court, then this case should be remanded to the Circuit Court for further proceedings to determine the claim of your petitioner to a lien upon and the right to possession of such shares and accumulated cash dividends thereon, which claim, though fully asserted, the Circuit Court failed to rule upon.

Specific Assignments of Error to be Urged.

The Court below erred:

1. In holding that Maryland Trust Company, as Trustee of Seaboard Air Line Railway First Mortgage, has a first lien upon and a right to possession of 2,225 shares of capital stock of Richmond-Washington Company which were issued to Seaboard as a stock dividend on October 31, 1930, and the cash dividends thereon collected and retained by the Seaboard Receivers;

2. In failing to hold that your petitioner, as Trustee of Seaboard Air Line Railway Refunding Mortgage, has a first lien upon and the right to possession of said 2,225 shares of Richmond-Washington Company and the cash dividends thereon collected and retained by the Seaboard Receivers.

Reasons Relied Upon for Allowance of the Writ.

1. The Circuit Court of Appeals has decided an important question of Maryland law in a way probably in conflict with Maryland decisions.

2. The Circuit Court of Appeals has so far departed from the rule of *Erie R. Co.* v. *Tompkins, supra,* as to call for an exercise of this Court's power of supervision.

See Par. 5 (b) of Rule 38 of this Court.

The *Pennsylvania* rule of apportionment between principal and income in respect of extraordinary dividends, both cash and stock, which the majority below failed to follow, is firmly embedded in the common law of Maryland. The dissenting opinion below of Soper, J., quotes the rule from the *Restatement of the Law of Trusts,* Vol. 1, section 236, as follows (R. 225):

> "Except as otherwise provided by the terms of the trust, if shares of stock of a corporation are held in trust to pay the income to a beneficiary for a designated period and thereafter to pay the principal to another beneficiary,
>
> • • • • • •
>
> (b) extraordinary dividends declared during the period, whether in cash or in shares of the corporation or in other property, are income to the extent and only to the extent that they are declared out of earnings of the corporation which accrued subsequent to the creation of the trust or the acquisition of the shares by the trustee;".

Commencing in 1894 with *Thomas* v. *Gregg,* 78 Md. 545, there are set forth in the margin the Maryland dividend

cases covering a span of forty-four years, which stand as frequent sentinels of Maryland's common law doctrine.*

Effective June 1, 1939, is Maryland's Principal and Income Act (Chap. 580 of the Laws of Maryland of 1939) which adopts the *Massachusetts* rule governing dividends. The statute is specifically non-retroactive (Sec. 10) and is not applicable to the pending question, except as it demonstrates by its own breadth of application the generality of the common law rule which it abrogates prospectively.

One reason stated by the Circuit Court majority for the rejection of the Maryland dividend cases is that such cases can be distinguished from the pending case in that the Maryland decisions involve the rights of life tenants and remaindermen, whereas the pending case involves parties to a contract of pledge in a corporate trust mortgage. Hence, argued the majority, to follow Maryland dividend cases would be reasoning from analogy. Inconsistently, however, in view of this supposed distinction and unwillingness to reason from analogy, the majority below adopted the precedent and reasoning of *Gibbons* v. *Mahon*,

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* Maryland dividend cases:

Thomas v. *Gregg, supra* (1894);
Quinn v. *Safe Deposit & Trust Co.*, 93 Md. 285 (1901);
Atlantic Coast Line Dividend Cases, 102 Md. 73 (1905);
Ex Parte Humbird, 114 Md. 627 (1911);
Coudon v. *Updegraff*, 117 Md. 71 (1912);
Foard v. *Safe Deposit & Trust Co.*, 122 Md. 476 (1914);
Washington Co. Hospital Assn. v. *Hagerstown Trust Co.*, 124 Md. 1 (1914);
Northern Central Ry. Dividend Cases, 126 Md. 16 (1915);
Miller v. *Safe Deposit & Trust Co.*, 127 Md. 610 (1916);
Krug v. *Mercantile Trust & Deposit Co.*, 133 Md. 110 (1918);
Spedden v. *Norton*, 159 Md. 101 (1930);
Baldwin v. *Baldwin*, 159 Md. 175 (1930);
Zell v. *Safe Deposit & Trust Co.*, 173 Md. 518 (1938);
Heyn v. *Fidelity Trust Co.*, 174 Md. 639 (1938).

Smith v. *Hooper*, 95 Md. 16, cited with approval by the majority below (R. 210), is not in point since it is not a dividend case.

supra (rejected by Maryland), itself a life tenant-remainderman case, as well as the income tax case of *Towne* v. *Eisner*, 245 U. S. 418, in which this Court set the example of reasoning from analogy by following the precedent and reasoning of *Gibbons* v. *Mahon*. The distinction which the Circuit Court majority invokes here was immaterial to this Court there.

As a justification for rejecting Maryland dividend cases, the majority opinion below employs the argument (self-defeating, we think) that to apply the Maryland rule to the pending case would result in a diminution of the First Mortgage Trustee's proportionate share of the entire capital stock of Richmond-Washington Company (R. 211). True, but the same would be equally true in the case of a remainderman. Said Soper, J. (dissenting):

> "* * * it cannot be that the rights of a pledgee are more sacred than those of a remainderman." (R. 227.)

The fallacy of the majority below is that in substance they question the *soundness* rather than the *existence* of applicable Maryland law. Local law as it is, not as it ought to be, controls. *West* v. *A. T. & T. Co.*, 311 U. S. 223; *Ruhlin* v. *New York L. Ins. Co.*, 304 U. S. 202.

The majority below further attempt to justify their disregard of Maryland dividend cases with the tenuous argument that the reservation to Seaboard in the First Mortgage of "all dividends" prior to default does not mean a reservation of income. Said Parker, J., speaking for the majority:

> "No such question is presented here. There is no reservation of income to the Seaboard." (R. 210.)

But the reservation of "all dividends" read in context and with circumstance obviously was for the very purpose of

reserving income. Since the First Mortgage by the terms of its granting clauses (R. 28) shows it to create a system lien conveying practically all of Seaboard's property, failure of Seaboard to reserve income would have been an act of financial hara-kiri. How would Seaboard keep its trains moving or meet its payroll? *Gibbons* v. *Mahon, supra,* relied on by the majority construed the word "dividends" as connoting income, and choosing the *Massachusetts* rule as preferable to the *Pennsylvania* rule, concluded that since a stock dividend is principal the word "dividends" did not comprehend a stock dividend.

In the pending case, there is no such freedom of choice as this Court had in *Gibbons* v. *Mahon.* The *Pennsylvania* rule, however strange and exotic it may seem in other jurisdictions, was entirely satisfactory to the Maryland Court of Appeals. Debate as to its merits is academic here.

In view of the weight accorded by this Court in *MacGregor* v. *State Mut. L. Assur. Co.,* .... U. S. ...., 86 L. ed. 559, to "the interpretation placed upon purely local law [Michigan] by a Michigan federal judge of long experience," we deem it significant that Judge Soper, who wrote the dissenting opinion below, served eight years as a Maryland federal district judge before he was elevated in 1931 to the Circuit Court.

Not to mention the confusion that the decision below, if allowed to stand, will inject into Maryland's hitherto well settled common law policy of apportionment relating to dividends, another important question of public interest is involved. The *Erie Railroad* case now is one of the rules governing legal relationships and transactions to which the public must conform. Is the rule inflexible, or on occasion will it bend and break according to the degree of unacceptability of local law? Can the public depend on it implicitly or must they temper their conduct with a

speculative and nebulous gauging of the breaking point where federal courts may employ immaterial and self-contradictory distinctions to escape the rule? The dissenting opinion of Soper, J., says there is no escape. (R. 220.)

WHEREFORE, your Petitioner respectfully prays that this petition be granted. No brief accompanies this petition.

Dated, March 23, 1942.

ALBRIDGE C. SMITH,
GEORGE M. LANNING,
IRWIN L. TAPPEN,
Counsel for the Petitioner.

(11)

Supreme Court of the United States

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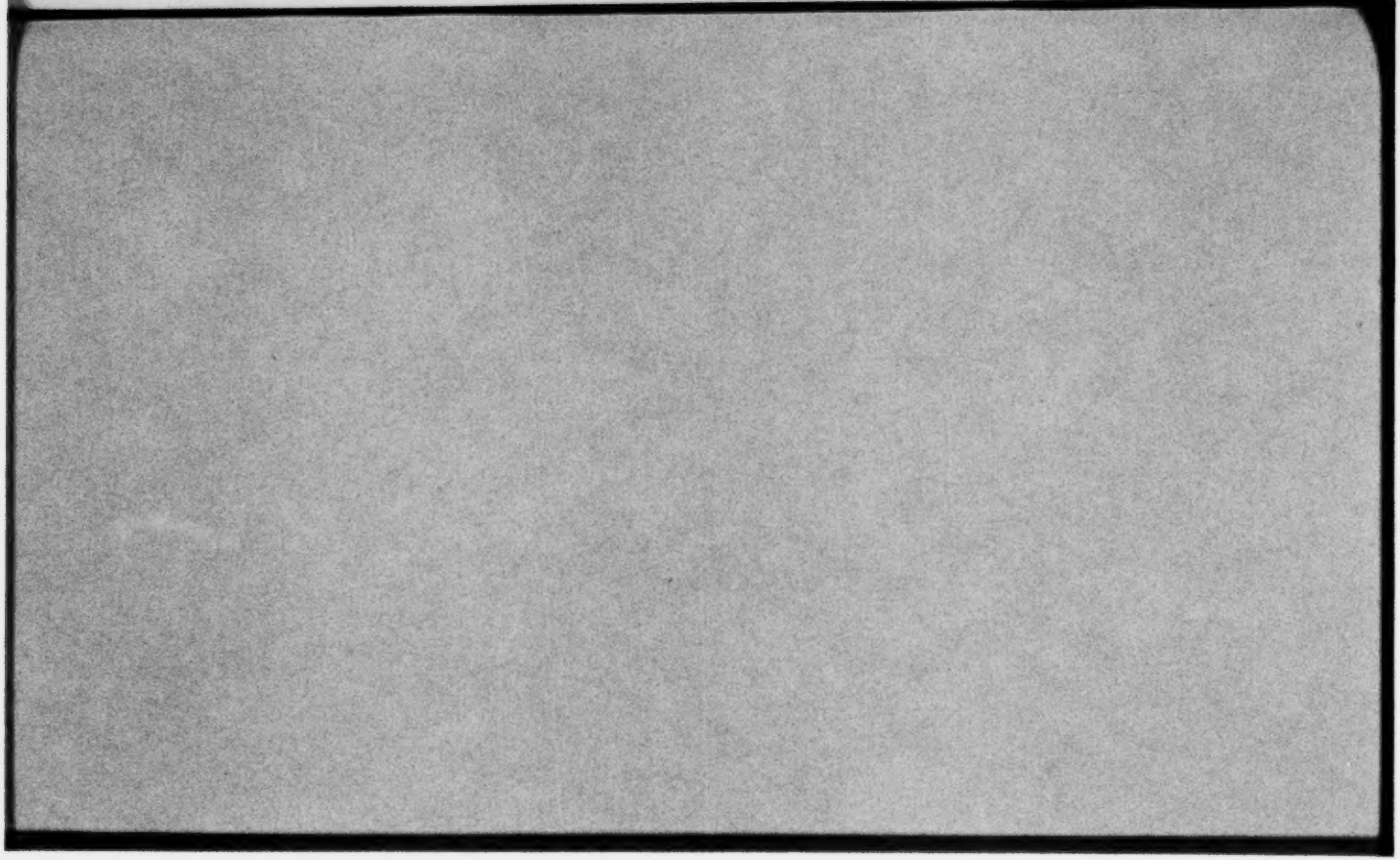

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To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner, THE NEW YORK TRUST COMPANY, as surviving Trustee of Seaboard Air Line Railway Refunding Mortgage, prays for a rehearing upon its petition for a writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit filed herein on March 26, 1942, and denied on April 27, 1942.

The essential facts and the question presented are contained in said petition. Jurisdiction of this Court is invoked

under Section 240(a) of the Judicial Code, as amended, by the Act of February 13, 1925 (C. 229, Stat.; 28 U. S. C. Sec. 347 (a)). The majority and dissenting opinions of the Circuit Court in the pending case are reported in *Powell* v. *Maryland Trust Co.*, 125 F. (2d) 260.

Reasons for Granting the Writ.

The petition in accordance with paragraph 5(b) of Rule 38 of this Court, set forth the following reasons for allowing the writ:

> "1. The Circuit Court of Appeals has decided an important question of Maryland law in a way probably in conflict with Maryland decisions.
>
> 2. The Circuit Court of Appeals has so far departed from the Rule of *Erie R. Co.* v. *Tompkins*, *supra*, as to call for an exercise of this Court's power of supervision."

Subsequent to the filing date of the petition, *Stentor Electric Mfg. Co.* v. *Klaxon Co.*, 3 Cir., 125 F. (2d) 820 (decided February 9, 1942), was published in the Federal Reporter under date of April 6, 1942, and was not in general circulation until several days thereafter.

This case and the *Stentor Electric Mfg. Co.* case, *supra*, present in vivid contrast two diametrically opposite viewpoints in regard to the rule of *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64, where a precise precedent does not exist in local decisions covering a particular state of facts.

In the pending case, on a question of Maryland common law the majority of the Fourth Circuit Court refused guidance from admittedly analogous Maryland decisions and felt free to revert to federal precedent relating to the nature of a stock dividend (*Gibbons* v. *Mahon*, 136 U. S. 549) even

though that case had been specifically rejected by Maryland (*Thomas* v. *Gregg*, 78 Md. 545). This method is the very antithesis of ascertaining Maryland law from "all the available data", which were manifold. The majority below, though paying lip service to the *Erie Railroad* case, did in fact disregard the available Maryland data and apply federal general common law, if such a thing still exists. Moreover, to make matters worse, the "federal common law" which the majority did apply had been consistently and repeatedly repudiated by the Court of Appeals of Maryland, as the dissenting opinion of Soper, J., so ably demonstrates. Under what theory can this extreme and hostile approach be deemed compliance with the *Erie Railroad* case?

On the other hand, the Third Circuit Court in the *Stentor Electric Mfg. Co.* case felt bound to ascertain state law "from all the available data" and diligently searched for "the approach of the Delaware Supreme Court" to the legal problem there involved (125 F. (2d) pp. 823, 824), notwithstanding that there were lacking analogous state court decisions such as exist in the pending case.

These two conflicting decisions create such obvious confusion as to call for clarification by this Court. A petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit was filed May 9, 1942 in the *Stentor Electric Mfg. Co.* case, *supra* (October Term 1941, No. 1229), in which at pages 13 *et seq.* the present case is cited and discussed as the chief cause of conflict among the judicial circuits.

The rising tide of chaos will continue to plague litigants and the lower federal courts until doubts are resolved. We venture to suggest that the present case and the *Stentor Electric Mfg. Co.* case, representing as they do extreme conflicting positions, furnish ideal instruments for a test

by this Court. May it not be that the true approach lies somewhere in between the two extremes?

In view of the foregoing additional reasons, your petitioner respectfully requests a rehearing and asks that its petition for a writ of certiorari, filed March 26, 1942, be granted.

The undersigned counsel for your petitioner certify that this petition is presented in good faith and not for delay.

Dated, May 16, 1942.

ALBRIDGE C. SMITH,
GEORGE M. LANNING,
IRWIN L. TAPPEN,
For the Petitioner.